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FOSTERING COMPETITIVE SHIPPING SERVICES (IMPACT OF PROGRESSIVE LIBERALIZATION ON THE DEVELOPMENT OF SHIPPING SERVICES)

Progressive liberalization and the development of shipping services in developing countries

Report by the UNCTAD secretariat

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SUMMARY AND RECOMMENDATIONS

(i) Since the late 1980s many developing countries have adopted - or are considering adoption of - policies favouring liberalization of shipping, privatization or commercialization of State-owned enterprises, or encouragment of private sector involvement and greater competition among shipping enterprises, national and foreign. Shippers in particular have increasingly exercised pressure for such policy changes in expectation of lower freight and charter rates and in the interest of effectively exercising freedom of choice of carriers.

(ii) The impact of such policy changes on national lines differs widely and depends on the ability of these lines to provide commercially viable services and to compete without the protective umbrella of market access restrictions and cargo reservations. While liberalization has stimulated the growth of shipping companies in some countries, it is clear that the performance of a large number of companies could be adversely affected by policy reform programmes. This will particularly be the case for lines that have developed large fleets under stringent government protection.

(iii) The commercial success or failure of shipping companies in a liberalized trading environment depends on such factors as the quality of management and shore-based personnel. It equally requires access to capital markets to finance fleet modernization programmes. Mostly, however, there appears to be a dire need to improve the responsiveness to market requirements rather than maintaining a public service approach.

(iv) Although liberalization may be expected to reduce freight rates, at least initially, over the long run rates may rise as the ensuing competition drives out some lines, leaving behind a few survivors, or as lines decide to cooperate over pricing or capacity levels. There is therefore a need to maintain a policy framework to ensure consultations between lines and transport users.

(v) In certain cases liberalization would require the removal of government ownership or controls over shippers' councils, and related organizations. Given that such institutions may have previously depended on government revenues or user charges imposed on shipments, arrangements would be required to restructure existing institutions or to establish new and financially viable councils capable of providing services to transport users. This process may call for external assistance.

(vi) Liberalization should not be undertaken in isolation. A comprehensive approach is needed to establish complementary competition policy to ensure that the competition and other benefits that result from liberalization are not eroded by possible development of market power among lines.

(vii) At the national level a liberalization programme has to address specific issues regarding formulation of measures and their implementation, including a determination of the extent and pace of liberalization. It needs to identify different measures to be taken and their sequencing, whether to allow protectionism to continue temporarily during the transition to full liberalization, and what actions are to be undertaken by governments to support the liberalization programme. It is recommended that, in its future work, the Committee should elaborate these mechanics of liberalization in order to permit developing countries to formulate effective liberalization programmes.

INTRODUCTION

(viii) This report has been prepared pursuant to the work programme in shipping, ports and multimodal transport, adopted by the Standing Committee on Developing Services Sectors: Fostering Competitive Services Sectors in Developing Countries - Shipping at its first session. With the aim of fostering competitive maritime transport services, the Committee decided, among other things, to assess the impact of progressive liberalization on the development of shipping services and examine difficulties faced by service suppliers of developing countries in providing competitive shipping services.

(ix) The report outlines the reasons for widespread protectionism and controls prior to the 1980s, and the motivation for shipping policy reforms, including liberalization, in the 1980s and 1990s. It gives selected examples of shipping policy reforms in developing countries and examines their possible consequences. It identifies several issues that need to be addressed in formulating a liberalization programme in shipping. Finally, it describes constraints faced by service suppliers of developing countries in providing competitive shipping services. The report is intended to provide a basis on which governments and other institutions may make appropriate decisions concerning the formulation and implementation of liberalization policy. The adoption of liberalized shipping policies by a large number of developing countries is a relatively recent development, and therefore the experience gained is only indicative.[1] Furthermore, while there may be a general perception that liberalization is beneficial, the expected benefits cannot be taken for granted, and it is essential for countries to be fully appraised of the possible benefits and costs before embarking on liberalization.

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[1]Some countries such as Chile have experienced long periods of liberalization. However, its geographical location has tended to protect it from competition, especially from wayport operators, and also over the years its lines continued to enjoy the cargo allocation schemes operated by its regional trading partners.

Chapter I

BACKGROUND

1. The late 1980s and early 1990s have seen a sweeping trend towards liberalization in countries around the world in all economic sectors. This trend has affected practically all developing countries, although in varying degrees. Policy reforms in individual sectors such as shipping have been closely linked to economy-wide policy reforms. At the macro level liberalization has included a relaxation of restrictions on imports and foreign exchange, a rationalization of import tariff structures and a reduction or elimination of State ownership and control of enterprises. Governments have also undertaken fiscal reforms, including the reduction of subsidies, encouraged foreign private investment and have generally promoted a greater role for the private sector.

2. With regard to the shipping sector, policy reforms have included or may include the elimination or reduction of subsidies to shipbuilding or shipping companies, privatization or commercialization of State-owned companies and the removal of State-administered cargo reservation schemes, licensing of liner operators, and other regulations.[2] It may also include other measures to increase competition such as allowing the promotion of foreign investment, the introduction of market-based criteria in the running of shipping enterprises, for example franchising, competitive tendering, etc. and promoting greater commercial flexibility as regards capacity, pricing and entry into trade routes.

3. The present report excludes a discussion of coastal shipping and related cabotage regulations applied by many countries. It also excludes a discussion of ports and inland transport services related to multimodal transport, as these may be subjects of separate reports of the UNCTAD secretariat. Furthermore, while both bulk and liner services are subjected to protectionism, the report's assessment of the impact of liberalization focuses on liner shipping. This is largely dictated by the fact that documented information on the results of liberalization in various countries is more readily available for liner services than bulk. Despite this, however, it should be emphasized that liberalization will generally have an impact on bulk shipping services in much the same way as liner services.

A. The origins of protectionism and regulatory controls in shipping in earlier decades

4. In order to put into perspective the developments in liberalization in shipping, a brief mention is made of the historical background of policy approaches that have evolved in different countries especially developing countries. From the 1950s up to the early 1970s protectionism and State intervention in the form of public ownership, government regulation and economic planning tended to dominate most economic sectors in developing countries, including shipping. This was attributed to a variety of factors, including the following:

(a) After independence, many developing countries were seeking policies to accelerate economic growth and establish social and political stability. Pioneering theories and policies of development economics emphasized the problems of market failure, the role of externalities and the potential for economic growth through government intervention in the form of direct production of goods and services and the regulation of private enterprise. Traditional economic theories, which had emphasized comparative advantage and efficient allocation of resources, were largely criticized for being 'static' and insufficient to address the needs of economic development.

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[2]While liberalization may involve modification of regulations, it does not necessarily imply complete deregulation or the elimination of competition rules.

(b) The lack of adequate private capital to finance large investments in most developing countries led to a situation in which governments were the institutions best suited to mobilize resources for such investments. Apart from investment, government regulation and assistance were widely used to protect "infant" industries which had to compete with well-established industries in the industrialized countries.

B. Forms of protectionism and regulations in shipping

5. Table 1 gives examples of forms of protectionism and State intervention applied to shipping in different countries, both developed and developing, during the 1960s and 1970s. It is evident that a fairly large number of instruments were used by governments to regulate and influence ship ownership and operations, and also shipbuilding. In addition to the measures listed in the table, many countries established State-owned shipping companies or instituted controls on ship operations, such as investment licensing, licensing of lines to operate on specific routes, controls on imports of vessels, etc.

6. While the sample of countries listed in table 1 includes only a small number of developing countries, a large number of others were also employing various protectionist measures. In Latin America most countries established cargo reservation schemes under which up to 50 per cent of cargoes were reserved to national flag carriers. In other cases certain cargoes were reserved exclusively for national flag carriers. In some countries of the region this policy was implemented through bilateral trade/shipping agreements with trading partners and also through pooling conference agreements under which only selected conference members belonged to the pools. Certain countries also used cargo reservation arrangements as an instrument for expanding local shipbuilding industries, which in addition were supported by financial subsidies. As a consequence of these measures a number of countries in the region, notably Argentina, Brazil, Chile and Peru, were able to expand their national fleets quite substantially.

7. In the African region, a clearly defined policy of increased participation in shipping by African countries was established in West and Central Africa, mainly under the umbrella of the Ministerial Conference of West and Central African States on Maritime Transport. By the end of the 1970s many countries of the subregion had set up national shipping lines and this initiative was supported by a widespread use of cargo reservation measures largely intended to promote the development of the national lines. These measures were carried out through government-affiliated shippers' councils or freight allocation bureaux. The countries of the subregion, largely basing their policy approach on the United Nations Liner Code, sought to guarantee 80 per cent of the whole liner trade to designated national lines at both ends of the trade, thus leaving 20 per cent of the cargo to third country lines. In certain cases the implementation of the policy involved, in a sense, a kind of collusion between the shippers' councils and conference carriers whereby the councils generated revenues from imposing user charges on shippers, while the carriers benefited from the protection given to them to have access to guaranteed cargoes with a virtual exclusion of potential competitors.

8. As in Latin America and Africa, protectionist measures were also instituted in certain Asian countries. An example of this was Sri Lanka where, throughout the 1970s and 1980s, the Government used the Central Freight Bureau (CFB) to control export cargoes in order to ensure priority of cargo access to the national shipping line. However, the CFB not only allocated cargoes to carriers, it also controlled sailing schedules, negotiated freight rates with liner conferences and dealt with problems relating to the adequacy and quality of liner shipping services. Protectionist measures were instituted in other Asian countries as well. Thus in varying degrees cargo reservation arrangements were established in Malaysia, Indonesia, Philippines and the Republic of Korea. On the other hand, State subsidies were employed in such countries as India and the Republic of Korea to assist shipping and shipbuilding industries.

Table 1

Summary of government aid measures to shipping and shipbuilding applied in the 1960s and 1970s

A. Aids to shipping

	Cargo preference schemes	Operating subsidies	Interest subsidies	Official loan guarantees	Construction subsidies	Tax/investment depreciation allowances	Cabotage restrictions
Argentina	X	X		X	X		X
Australia		X			X	X	X
Belgium			X	X		X	
Brazil	X	X	X		X		
Canada						X	X
Chile	X	X				X	X
Colombia	X					X	X
Denmark			X			X	X
Ecuador	X						X
Finland			X	X		X	X
France	X		X				
Germany				X	X	X	X
Greece			X	X		X	X
India	X					X	X
Indonesia	X						X
Ireland					X	X	
Israel							
Italy							X
Japan						X	X
Rep. of Korea	X	X		X			
Malaysia	X					X	X
Mexico	X	X		X		X	X
Netherlands				X	X	X	
Norway				X		X	
Pakistan	X				X	X	X
Peru	X	X		X	X	X	X
Philippines	X		X	X		X	X
Portugal		X		X			
Singapore			X				
South Africa			X	X	X		
Spain	X		X		X		X
Sweden						X	X
Turkey	X		X				X
UK							
USA	X	X		X		X	
Uruguay	X					X	
Venezuela	X						X

B. Aids to shipbuilding

	Direct subsidies	Export credits	Domestic subsidies	Tax allowances	Duty-free imports	Other
Argentina	X					
Australia					X	
Belgium		X	X		X	
Brazil		X			X	
Canada		X			X	X
Chile					X	
Colombia						
Denmark		X	X		X	X
Ecuador						
Finland		X	X		X	
France	X	X	X			
Germany		X	X		X	X
Greece			X			
India	X					
Indonesia					X	
Ireland				X		
Israel				X	X	
Italy	X	X	X	X	X	X
Japan	X	X	X		X	X
Rep. of Korea		X	X	X	X	
Malaysia						
Mexico	X					
Netherlands	X	X	X		X	X
Norway		X	X	X		X
Pakistan						
Peru						X
Philippines	X				X	X
Portugal						
Singapore						
South Africa						
Spain	X	X	X	X		X
Sweden	X	X	X		X	
Turkey						
UK	X	X	X	X	X	
USA	X		X			
Uruguay					X	
Venezuela						

Source: "Imbalance between supply and demand in world shipping: supplementary report", Report by the UNCTAD secretariat (TD/B/C.4/312).

Chapter II

SHIPPING POLICY REFORMS AND LIBERALIZATION IN THE 1980s AND 1990s

A. The impetus for liberalization

9. Moves towards liberalization of shipping services have for the most part been the product of policy reforms at the macro level. In this connection, up to the early 1970s, developing countries had generally experienced satisfactory rates of national economic growth, and therefore prevailing policies had not been called into question. The general trend towards liberalization, as witnessed in the 1980s and 1990s, has in large part resulted from poor economic performance, including fiscal shortfalls, large external debts and high rates of inflation. In this connection the comparatively better economic performance of some developing countries which had earlier adopted liberal, outward-looking economic policies has been perceived as evidence of the efficacy of liberalization. Some policy makers have therefore regarded economic reforms, including liberalization, as an important avenue for overcoming the prevailing economic difficulties.

10. Both internal and external pressures also reinforced reforms in developing country economic policies. In particular, pressures for policy changes have been exerted by foreign creditors, especially the International Monetary Fund and the World Bank, which have conditioned lending on the adoption of liberalized policies and structural reforms.

11. New thinking in the theory of industrial organization, especially regarding the role of potential competition from outside a market, has provided an additional argument for liberalization. In particular, the theory of contestable markets contends that, where there are no sunk costs and entry barriers, potential competition exerts an influence on the performance of a market or the behaviour of firms, leading to optimal pricing and the elimination of anti-competitive practices. Thus where markets are contestable the need for public regulation is greatly reduced. In the case of shipping, it has been suggested that markets in liner services are largely contestable and therefore do not require strong government regulations to ensure efficiency and the elimination of anti-competitive practices.

12. With specific reference to liner shipping, protectionism has been blamed for creating distortions or inefficiencies in the supply of services. Thus, for example, it has been pointed out that cargo reservation schemes and other regulatory controls have restricted the supply of services to shippers and this, in turn, has hampered trading opportunities. The protection granted to some national shipping lines has allowed such lines to maintain inefficient services and charge high, uncompetitive freight rates. It has also limited the incentive for the lines to adopt new technologies and innovations. These factors have raised operational costs, thus contributing to the lines' poor financial performance and continued reliance on subsidies. In fact, despite the protection accorded to some shipping lines, such lines have been uncompetitive in terms of quality of service, and this has also contributed to their unprofitability.

13. Many governments have realized that national fleets cannot be sustained indefinitely through government protection. Also in the context of economic adjustment programmes, foreign creditors have viewed liberalization in shipping as a means of reducing government spending, lowering levels of freight rates and increasing shipping service efficiency, which in turn would increase trade and stimulate economic growth.

14. Shipping policies adopted by developed market-economy countries may also have played an important part in encouraging liberalization in shipping in developing countries. In particular, the application of some of the regulations under the European Union common shipping policy appears to have encouraged certain developing countries to reconsider their shipping policies.

B. Examples of shipping policy reforms undertaken in developing countries

15. Table 2 gives a summary of selected examples of shipping policy reforms introduced or proposed in developing countries in recent years. The information is based on replies to a questionnaire which the UNCTAD secretariat sent to governments requesting, *inter alia*, information on shipping policy reforms already introduced or being introduced by the countries with a view to liberalizing the maritime sector. Additional information was obtained from various published sources. Owing to the changes introduced from time to time in some of the measures adopted by governments, the examples of policy reforms given in the table should be taken as an indication of the general direction of policies rather than a precise account of fixed policies.

Table 2

Selected examples of shipping policy reforms in developing countries

The Andean Group (Bolivia, Colombia, Ecuador, Peru and Venezuela). Through Decision 288 of 21 March 1991 - "Freedom of access to cargo carried by sea within the subregion", the Group adopted a policy aimed at reducing restrictions on access to seaborne cargoes. It provided for freedom of access to cargoes shipped within the subregion in vessels owned, chartered or operated by shipping companies of member countries and third countries. It also provided for member States to adapt their domestic rules in order to abolish: existing restrictions on the chartering of ships by shipowners in member countries; the allocation of routes within the subregion; and systems for the fixing or authorization of freight rates by the appropriate authorities, which were to be replaced by simply filing tariff schedules. However, the Decision provided for transitional measures at the subregional level, whereby member countries were authorized to establish trade restrictions and exclusions or cargo reservations, or take any other measures it deemed fit concerning companies or vessels of non-member countries that applied restrictive or discriminatory rules with regard to ships owned, chartered or operated by the shipping companies of member countries. In Decision 314 of 4 February 1992 - "Freedom of access to cargo carried by sea for the development of the Andean Group Merchant Marine", restrictions on foreign capital ownership in national shipping companies were relaxed in order to permit increased foreign investment.
Brazil: In August 1990 Decree 666 was amended to make exports of coffee, cotton and cocoa free from the Decree's cargo reservation requirements. In January 1991, the Government issued "portaria" No. 07/91, providing, among other things, for (a) Brazilian vessels to be free to carry any general cargo and liquid or solid bulk cargoes; (b) Brazilian vessels to be utilized on any route chosen by the shipping companies themselves, although changes or additions to routes on which a line can operate have to be communicated to the Government (c) the abolition of the system of reserving cargoes to Brazilian flag carriers and the use of cargo pools; (d) Brazilian shipowners to be free to charter foreign ships, provided that Brazilian registered vessels were not available. However, the longstanding Decree 666 has not been abolished. This Decree is the basis of Brazil's wide-ranging cargo reservation schemes.
Sri Lanka: According to a government directive of December 1989, the shipping policy of Sri Lanka was liberalized with effect as of 1 January 1990. The elements of the new policy included the following: (a) shipping lines given freedom to canvass and load export cargoes from Sri Lanka subject to their being registered with the Central Freight Bureau (CFB), (b) exporters given full freedom of choice to select any registered shipping line on which to load their cargoes, (c) freight rates to be determined by market forces and not through government controls, (d) The CFB's exclusive powers to book/allocate cargoes were abolished. Instead the Bureau was given responsibility to collecting and disseminating shipping data to the industry, and was empowered to act as an impartial mediator between shippers and shipping lines in relation to freight rates, surcharges, abuses, double booking of cargoes, etc.

India:
(A) 1991/92- The private sector has been granted greater role in the shipping industry, through a system of automatic approval to private shipping companies in the acquisition of ships.
(B) Freedom granted to shipping companies to acquire ships through bare boat chartering
(C) Removal of the requirement of Indian shipping companies to be licensed in order to operate liner services on given routes;
(D) Automatic approval to be given for the sale of ships
(E) Freedom to charter out of vessels (Previously chartering out was subject to government approval
(F) Non-resident Indians of Indian nationality or origin and overseas corporate bodies owned to the extent of 60 per cent or more by non-resident Indians are allowed to invest up to 100 per cent equity in India's shipping companies with full repatriation benefits.
(G) The flagging out of vessels as a means of external borrowing and mortgage is permitted
(H) A reduction in Government-controlled cargoes made available to Indian shipping lines on preferential basis.

Republic of Korea
(A) The gradual elimination of the existing cargo reservation system under which certain cargoes are reserved to flag vessels of the Republic of Korea. Currently two kinds of cargo reservation systems exist. The first kind, the waiver system which applies to liner cargoes transported on near sea routes, is to be eliminated by January 1995. The second kind is the designated cargo system imports of crude oil, ore, fertilizer raw materials, grain, coal, raw materials for petrochemical products, coal, liquified gases, reefer and refrigerated cargoes, government procurement cargoes, and exports of cement and steel products. This system is to be eliminated by the year 2001.
(B) The removal, during 1993, of restrictions on investments by foreigners in shipping-related businesses such as freight forwarding.
(C) The gradual removal of a licensing system which restricts shipping companies to operate only on routes or in areas for which they are licensed.

Indonesia:
Inpres 4/1985 abolished the system whereby foreign carriers wishing to visit an Indonesian port were required to appoint an Indonesian agent and to obtain a general agency permit. The permits were valid for one voyage only and were used to protect Indonesian flag carriers and to support direct as opposed to transhipment services to one of nominated Indonesian ports. The abolition of the system has allowed Indonesian and foreign carriers to operate freely on any desired international route, with any desired frequency through an Indonesian port of their choice.

Chapter III

THE IMPACT OF LIBERALIZATION ON SHIPPING SERVICES

A. Methodological approach

16. An assessment of the impact of liberalization has to be based on the rationale underlying the adoption of the liberalization policies themselves. As observed earlier, the main stimulus for policy reforms and liberalization has come from the desire to improve productive or operational efficiency, to reduce freight rates and overcome other negative factors that have resulted from protectionism and government controls. Consequently, indicators of the impact of liberalization or reforms would include such factors as changes in freight rates and levels and quality of service. However, a complete evaluation must also examine the effects on other aspects of the industry that are of concern to policy makers, such as the participation of developing countries in ship ownership and operation, changes in market structures, and consequential changes in the roles of institutions, for example, shippers' organizations, as well as changes in the roles of existing regulatory instruments.[3]

17. The present report attempts to predict the outcome of adopting various forms of liberalization measures. These measures were defined earlier to include the elimination or reduction of government subsidies, privatization of State-owned shipping enterprises, the removal or reduction of cargo reservation schemes and restrictive licensing of operators, the general promotion of competition and greater use of commercial principles in shipping enterprises and the opening up of investment opportunities to foreign companies. To the extent that data are available, the report analyses changes which such measures are expected to bring about in the various factors mentioned above, e.g. freight rates, level of services, etc.[4] However, an assessment of the outcomes of liberalization in shipping are largely preliminary given that major policy reform initiatives in this sector have occurred only in the last few years and some are still being put into effect. Furthermore, the report recognizes that observed changes in the factors examined cannot be attributed solely to liberalization measures. Consequently, in certain cases, the possible influence of other factors is discussed in order to qualify the overall impact of liberalization. Also it needs to be emphasized that the nature and magnitude of the effects of liberalization will vary according to the intensity of the measures adopted, the economic environment of the country concerned and other external factors.

B. Prediction and examples of the impact of liberalization

1. Impact on the participation of developing countries in shipping

18. Most of the liberalization measures mentioned earlier are likely to affect the participation of developing countries in ship ownership and operation. A relaxation of cargo reservation would result in carriers for whom cargoes were previously reserved having to compete for cargoes in the market. In particular where shipping companies have been established and sustained largely under the protection of cargo reservation, it is highly likely that, at least at the initial stages of liberalization, their ability to compete would be quite limited, adversely affecting their operations and fleet ownership position.

19. The removal of shipping subsidies and other forms of assistance to shipping would equally affect the participation by developing countries. In the past the shipping companies of many developing countries have relied on government financial support for both the purchase and operation of ships. As a consequence of the continued depression of freight markets, profitability will remain low. Thus, shipping lines are unlikely to generate sufficient retained profits from which to finance equity investment. In the absence of government subsidies, they must therefore rely on alternative sources such as capital markets, international

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[3]Ideally, changes in other factors characterizing protected services, e.g. slow technological progress and innovation, poor management, etc, should be evaluated. However, this is constrained by the lack of the requisite data.

[4]Isolated examples of the outcomes of liberalization in selected trades are reported in the maritime press from time to time, but they do not provide a comprehensive or consistent account.

commercial bank loans, export credits offered by foreign governments, etc. However, capital markets are generally underdeveloped in most developing countries and, except for a few countries where such markets have grown, they have tended to play a marginal role in financing ship acquisitions. Funding from international commercial banks is also limited, as major banks have reduced their lending for ship acquisition on favourable terms, following the large losses they incurred from loans in the 1980s. Furthermore, where they make loans they are apt to be selective, limiting their lending to the most reputable borrowers, which tend to include a limited number of shipowners of the developing countries. Local commercial banks have usually not been a major source of ship finance in developing countries. Access to investment funds is also limited as many of the developing countries still have large external debts which make lending to their enterprises risky. Finally, many developing countries suffer from chronic foreign exchange shortages. This tends to limit the ability to import vessels even if a company has the required funds in local currency.

20. The financial constraints are not limited to ship acquisition. The depressed freight markets also adversely affect normal operating profits, causing companies to sustain losses that quite often have to be subsidized by the State to ensure the continued existence of the companies. Consequently, a reduction or elimination of State subsidies and other financial assistance to shipping may jeopardize the survival of the shipping companies of many developing countries.

21. The participation of developing countries in shipping will also be adversely affected as a result of the removal or reduction of State-owned companies and the introduction of a greater role for private ownership. Up until now the majority of developing countries involved in shipping have operated through State ownership of shipping companies. While State ownership as such need not necessarily contradict a policy of liberalization, it appears likely that intervention in the form of cargo reservation, subsidies, etc. is more likely, and much easier to establish, under State ownership. As a shareholder, the State is more inclined to use various measures at its disposal in order to protect its own investments. The privatization or commercialization of State shipping companies could therefore be seen as a vehicle of liberalization.

22. Concerning privatization, account should be taken of the fact that in many developing countries there are usually few local individuals or private enterprises with the capital required to purchase a controlling number of shares in a sizeable shipping company. Thus, a possible outcome of privatization is the encouragement of direct foreign investment. However, the attraction of such investments appears to be quite limited in the currently poor state of shipping markets.

23. With regard to the lack of local capital for ship acquisition, it has been suggested that ship operators in developing countries might overcome this constraint by chartering tonnage and/or buying container slots. Similarly, related equipment including containers, trailers, trucks, etc. can be leased. In fact the existence of charter/leasing markets has enabled some small operators to enter the market and provide effective competition. In spite of this, however, ownership of vessels remains an important feature of liner, including container, shipping. Owned vessels and equipment are considered to be strategic investments that operators regard as essential in ensuring reliable and flexible services. Ownership is also used as a measure of security against unforeseen fluctuations in charter rates. It may also give an indication to shippers of a carrier's commitment to a trade. It has been observed that, while lines do not necessarily need to operate owned ships, they nevertheless have a preference for ownership in order "to have control over slot provision costs, to have a reliable schedule and ... to promote a corporate/brand identity. It is only through long term control (essentially ownership) that a line can guarantee the continuity of service which is so important in the marketing of container operations."[5] Also it would seem that there is a limited supply of tonnage in the charter market for specialized container vessels, e.g. ROROs. Containerisation International[6] provides data for selected top container service operators, which show that as of 1 July 1992 the share of container slots

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[5]Drewry, *Strategy and profitability in global container shipping*, November 1991, p. 33.

[6]*Containerisation International*, August 1992, p. 44, table 5.

operated that was chartered-in averaged around 30.9 per cent. This gives a rough indication of the relative importance of owned tonnage, although there are no hard figures on required minimum levels of tonnage shares which should be owned. This appears to be the situation among smaller operators as well.

24. Information on a few developing countries suggests that, immediately following the introduction of liberalization, volumes of cargoes available to or lifted by national shipping lines that had formerly been protected fell significantly. For example, table 3 illustrates the decline in cargo liftings experienced by the Ceylon Shipping Corporation of Sri Lanka between 1989 (when liberalization was introduced) and 1991. There are indications that in certain countries the consequences may have been more dramatic. For example, certain State-owned lines in South America have experienced severe financial losses, leading to a reduction in services or a withdrawal from others, as a direct result of liberalization.

25. Another indicator of participation is fleet ownership. Since the early 1990s, the fleets of many developing countries, especially in Latin America and Africa, have declined, and some individual lines have experienced serious financial and operational problems, which have been attributed directly to the liberal policies adopted by the countries concerned. The very existence of some lines has thus been threatened, although the final outcome is still uncertain.

Table 3

Percentage share of Ceylon Shipping Corporation's cargo liftings
(Percentage of total liftings)

Trade	1989	1990	1991 (Jan-May)
UK/Eire	90.6	82.3	61.7
Europe Continent	84.4	77.2	47.6
Mediterranean/Adriatic/French ports	0	0.2	0.03
Egypt	64.6	2.7	0
USA	11.0	1.5	0.4
Far East	72.0	31.0	18.6
China	31.0	33.0	0
Persian/Arabian Gulf	11.4	20.0	5.6
Red Sea	47.6	25.0	0.5

Source: "Study on sea freight", unpublished consultant's report, Sri Lanka, August 1991.

26. However, it appears generally impossible to establish a clear link between liberalization and changes in fleet ownership. For example table 4 shows changes in liner tonnage owned by selected developing countries. Except for the Philippines, all 10 countries listed experienced an overall tonnage decline during 1986-1992. The drop occurred throughout the period. Thus, for example, in the case of some countries such as Argentina, Brazil, Colombia and Sri Lanka which underwent liberalization during the 1989-1991 period, the decline commenced well before the policy reforms were initiated, although the declines which occurred in 1990-1992 (post-liberalization years) were relatively higher than those of the pre-liberalization years. It is also significant that, for example in the case of Mexico, over the period the fleet fluctuated both upward and downward.

27. Changes in the size of national fleets fail to reflect the fact that, in some countries, while liberalization has adversely affected previously protected national lines, it has at the same time promoted the entry or expansion of other national operators. For example, some new operators have benefited from liberalization by being able to enter the market unrestricted by entry regulations. They have adopted cost-cutting measures, including entry into cooperative arrangements with other lines, and employed modern container ships. Other lines, on the other hand, especially those which had established large fleets under protection, have tended to be slow in adopting new technologies and have continued to employ old multipurpose ships that have proved to be uncompetitive *vis-à-vis* container ships. Furthermore, these lines, some of which

are State-owned or State-controlled, have found it difficult to restructure their operations and take other measures to improve performance.

Table 4

Annual percentage changes in the liner fleet tonnages of selected developing countries, 1986-1992

Year	Argentina	Brazil	Chile	Colombia	Côte d'Ivoire	India	Mexico	Nigeria	Philippines	Sri Lanka
1986	-11.0	-7.4	36.5	10.2	-13.71	-11.2	-17.2	21.9	10.6	-10.0
1987	-13.1	-0.9	-2.0	5.3	-1.32	-4.9	-5.1	10.9	7.5	-6.8
1988	-3.6	-8.3	0.1	-3.8	0.0	-7.6	12.2	-0.8	13.4	17.5
1989	-9.2	-15.9	-0.6	-8.4	-32.9	-12.6	-70.4	-31.8	10.1	-11.5
1990	-6.0	-19.0	2.0	-2.0	0.0	-1.2	29.0	-6.5	-8.7	-34.0
1991	-17.4	-23.4	-10.0	-18.3	-1.0	-8.7	15.2	-1.6	10.1	-7.1
1992	-17.7	-19.7	-46.5	-21.7	1.0	-6.3	-31.2	3.18	2.1	-29.0

Source: UNCTAD, *Review of Maritime Transport*, various issues.

28. One conclusion from the above is that a strong link cannot readily be established between shipping policy reforms and a country's participation in shipping. It is evident that other factors play a role. For example, market developments in liner shipping may have forced some developing countries to sell off or replace their obsolete, conventional vessels and/or to rely to a higher degree on chartered tonnage or slots. Similarly, new entries may have started off by buying slots rather than owning tonnage, a factor that cannot be revealed from information on fleet ownership. Some developing countries have also registered their ships in open registries. In addition, the fleet decline may have been the result of the continuing world economic recession, which has generally reduced cargo availability.

29. Other developments in the shipping industry make it difficult to predict the future impact of liberalization on the participation in fleet ownership or operations. Liberalization would, in theory, be expected to promote competition and permit easy entry to shipping lines. While competition appears to have increased in most liner trades, at the same time there has been a tendency towards concentration of the industry.[7] This tendency means that in the long run liberalization may severely restrict the ability of some developing country carriers, usually the weaker competitors, to participate in ship ownership or operations.

30. It is therefore evident that, as developing countries liberalize their shipping services, their continued participation in the industry is uncertain and may be conditional on the ability of their shipping lines to take measures that make them more competitive. This may involve a restructuring of shipping companies' operations and cutting costs. Some countries have resorted to flagging out vessels as a means of reducing operating costs while others have contemplated the setting up of second registries. Other measures would involve the rationalization of services, especially through cooperation with other carriers in order to benefit from economies of scale, although the success of such cooperation may be dependent on the ability of a carrier to find partners with compatible vessels and marketing arrangements. The constant changes in alliances between carriers in various trades is testimony to the fact that cooperation is motivated by strategic factors which may encourage carriers to

[7]The movement of liner shipping towards greater concentration is discussed below in section 6.

be selective when choosing partners. However, in many North-South trades, which are the main markets for the majority of developing country operators, local shipping lines have been able to team up with developed country operators. In some cases whole conferences have been transformed into joint service/space sharing agreements thus affording developing country operators access to modern tonnage. In some such cases some developing country operators only provide back-up multipurpose tonnage or they operate just as non-vessel-operating common carriers.

2. Impact on freight rates

31. Trades of countries employing cargo reservation and other regulatory controls on the supply of shipping capacity are expected to experience relatively high freight rates, since cargo is allocated inefficiently among carriers, and service supply is restricted to levels below the optimum that would have existed in the absence of controls. The shipping lines to which cargo is reserved, by not being exposed to competition, are in a position to charge rates well above competitive levels. Furthermore, as indicated earlier, protected lines lack incentive to adopt new technologies and innovations, and this makes their operating costs high, thus putting pressure on freight rates.

32. A reduction in freight rates is therefore one of the main results expected from liberalization. The impact of liberalization can be assessed by comparing levels of freight rates between regulated or protected and non-regulated shipping markets. For example, it has been suggested that in the Europe-West Africa trade, cargo reservation arrangements have been employed to a lesser extent in the trades to and from Nigeria and Ghana than in the trades of other countries of the region. As a consequence non-conference competition has been relatively greater in Ghana and Nigeria trades than in the other countries, where conference lines have been able to control between 60 to 80 per cent of the relevant cargoes. The result has been that freight rates in the less protected Nigeria and Ghana markets are on average lower than in the more protected markets. Figure 1 plots TEU rates applicable in mid-1991 for selected products in four different services sectors of the United Kingdom/West Africa liner trade. It shows that, except for project cargo, rates for the Ghana/Nigeria sector were indeed lower than those of the other countries, including Senegal which is a shorter distance from the United Kingdom.

33. The alternative to the cross-sectional comparison is to compare, for the same trade, levels of freight rates before and after liberalization. In Sri Lanka liberalization led to significant rate reductions for certain products such as garments and tea on some routes. The fact that these reported rate reductions were fairly large, and came immediately in the wake of liberalization, would support the view that they had more to do with the liberalization than the longer-term expansion in non-conference competition and a weakening of conferences. In Brazil and Colombia, it is reported that the expansion of competition that followed liberalization had the effect of pushing down rates very significantly. Figure 2, for example, shows movements of freight rates for selected products in trades between Europe and Brazil over the 1988-1993 period. For both southbound and northbound trades, rates showed a downturn in 1991 of far greater magnitude than that of the previous years. This clearly coincided with the introduction of the country's liberalization measures.

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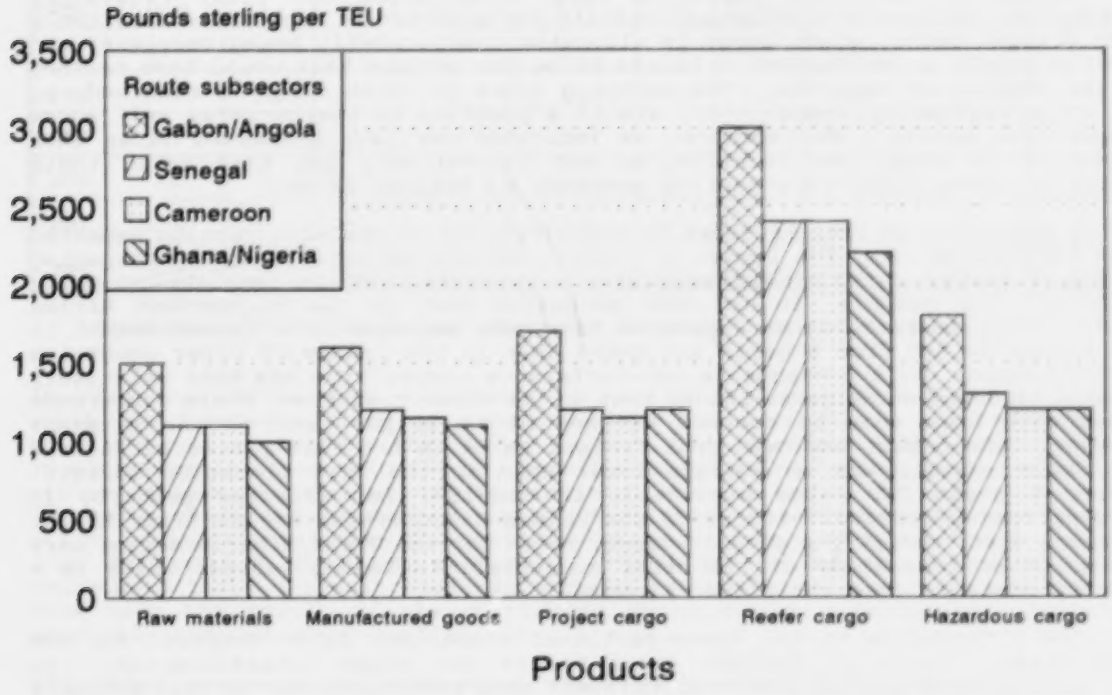
Figure 1

Freight rates for selected products in different United Kingdom-West Africa liner trade service sectors, mid-1991
(pounds sterling per TEU)



Source: Based on data supplied by shipping lines.

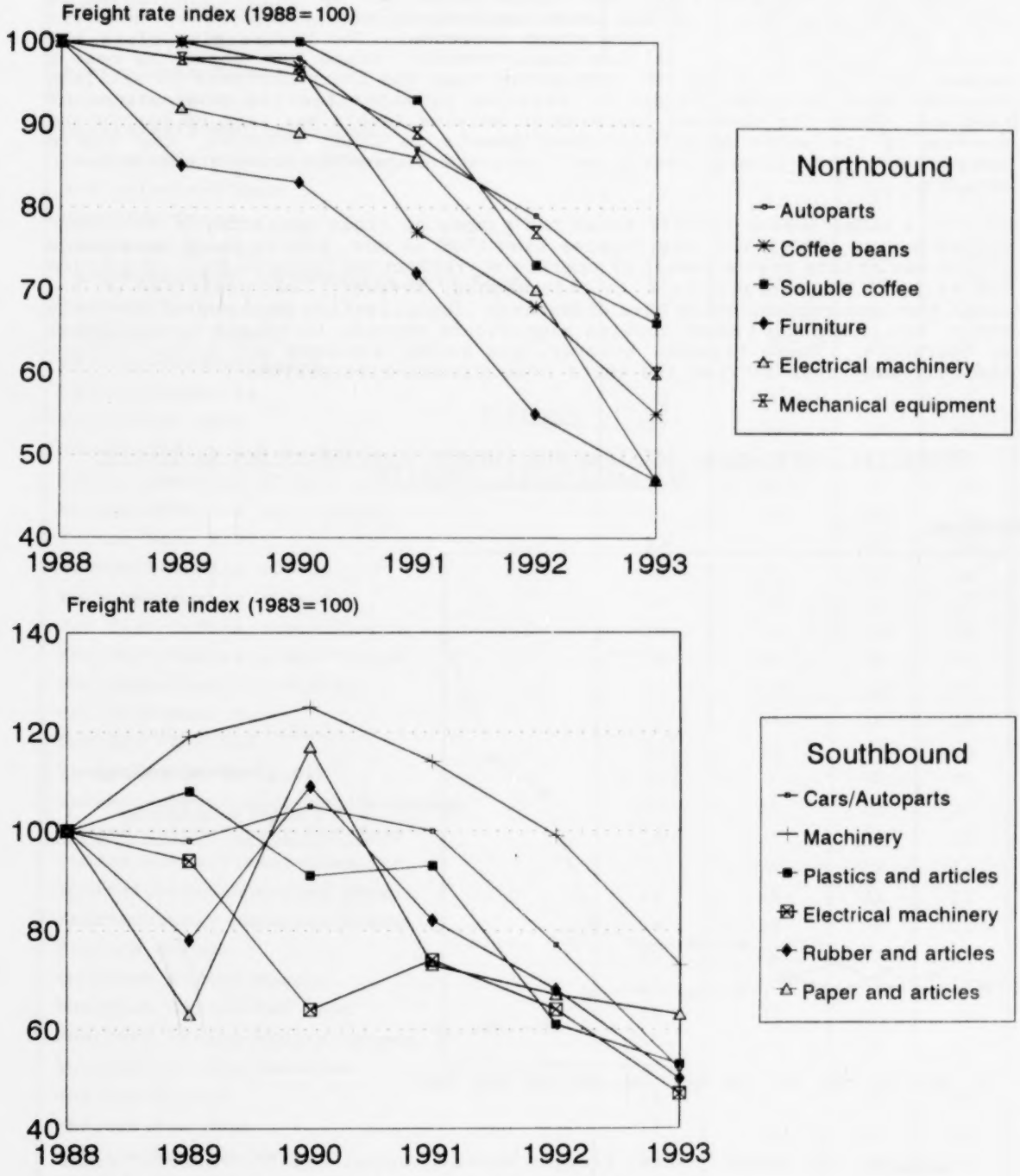
34. However, it is notable that in the Sri Lankan case the initial drop in freight rates was after a while followed by announcements of general rate increases. This would suggest that the competition that follows liberalization may lead to freight wars in which only the strongest lines will survive, and these may be in a position to raise rates once the competition is eliminated. Alternatively it may be that the initial rate reductions are used by lines to gain market access, and once the markets are carved up the lines may start entering into cooperative arrangements which would push up rates.

3. Impact on the level and quality of services

35. By opening up services to free markets and competition, liberalization may improve the level and quality of services. Service improvements involve changes in a range of service characteristics, including the number of carriers operating on a route, the number or frequency of sailings, transit times, the equipment and vessels utilized and their age and technological profiles.

Figure 2

Changes in freight rates for selected products in the Europe-Brazil liner trade, 1988-1993



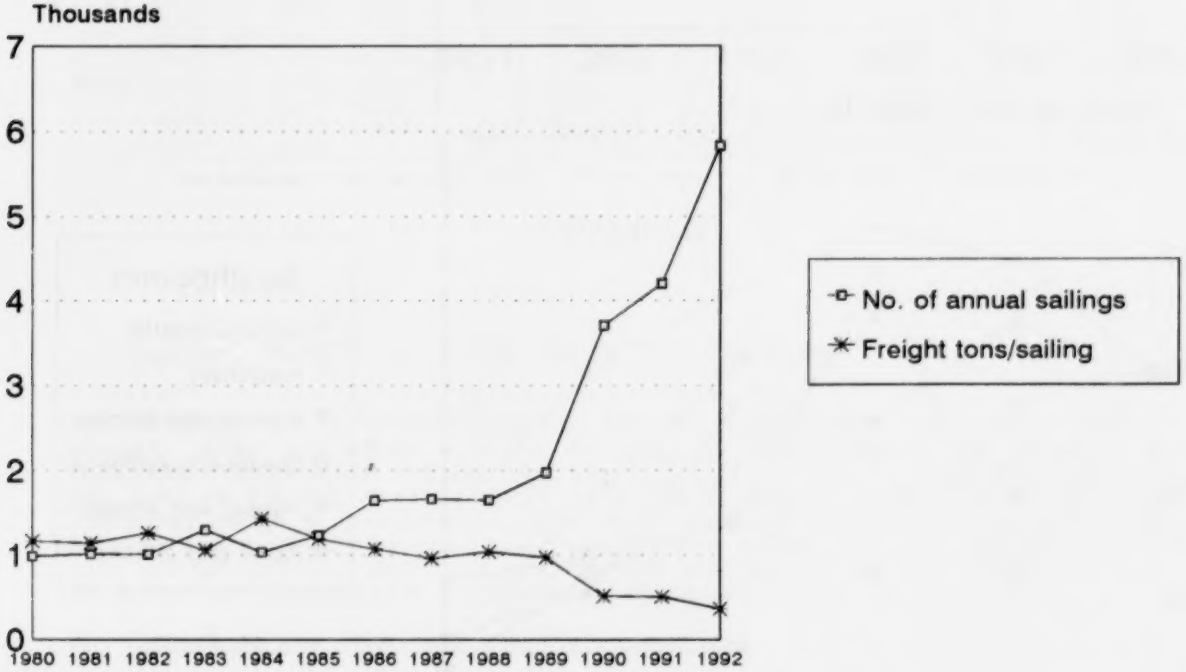
Source: Based on data supplied by shipping lines.

36. Liberalization would be expected to increase competition by allowing free entry to shipping lines that previously may have faced entry restrictions. The inevitable result would be an increase in the number of operators and sailings in the trades concerned. As an example, figure 3 shows the increase in the number of sailings in Sri Lankan trades that can be attributed to the relaxation of cargo restrictions in 1989. The figure shows that up to 1989 the number of ship sailings into and out of Sri Lanka remained relatively unchanged. However, since 1989 there has been a very sharp increase. The figure also plots the number of freight tons per sailing (load factor). Since 1989 there has been a marked decline in load factors, indicating that the sharp increase in sailings resulted from increased levels of services provided for the same volume of cargoes. While the observed increase in service levels may also be partly the outcome of the wider structural developments in liner shipping, the figure demonstrates that liberalization as a separate factor can bring about dramatic results.

37. On a wider scale, table 5 shows the number of lines operating on different routes during 1990-1992. The figures show that on most routes there were large annual variations in the number of operators, reflecting large numbers of entries and exits. It is significant in this regard, however, that countries of the South American region, which have undertaken liberalization measures in the early 1990s, are among the trades showing significant overall increases in the number of operators. These figures, however, are annual averages and do not reflect the full extent of entries and exits over shorter time periods.

Figure 3

Number of liner vessel sailings and freight tons lifted per sailing at Sri Lanka ports, 1980-1992



Source: Sri Lanka Central Freight Bureau, Annual Report, various issues.

Table 5

Number of lines operating on different trade routes, 1990-1992

Name of trade route	1990	1991	1992	1993
Australasia-EAsia	20	21	25	24
Australasia-Europe	17	19	15	16
Australasia-Japan/Korea	21	25	22	21
Australasia-Mediterranean	14	19	16	16
Australasia-NAmerica WCoast	9	9	10	11
Australasia-SEAsia	17	23	27	31
CAmerica-Europe	24	18	20	20
Caribbean-Europe	21	22	26	28
Caribbean/CAmerica-NAmerica Gulf Coast	16	18	19	20
EAfrica-Europe	17	15	15	11
EAfrica-Far East	7	8	8	8
EAfrica-Mediterranean	17	10	15	15
EAfrica-NAmerica	6	4	4	3
Europe-Far East	37	41	38	41
Europe-Indian subcontinent	25	29	27	25
Europe-NAmerica ECoast	27	27	27	28
Europe-NAMerica Gulf Coast	14	15	16	14
Europe-Near East	33	36	40	36
Europe-SAmerica ECoast	24	34	36	34
Europe-SAmerica WCoast	14	19	20	17
Far East-Indian subcontinent	28	14	24	25
Far East-NAmerica Gulf Coast	15	8	9	8
Far East-NAmerica WCoast	26	29	28	27
Far East-Near East	11	14	16	18
Far East-Red Sea	13	13	17	20
Indian Ocean-Europe	10	8	9	10
Indian subcontinent-Mediterranean	19	16	23	20
Indian subcontinent-Mid-East	14	21	27	23
Indian subcontinent-NAmerica	12	9	12	13
Mediterranean-NAmerica ECoast	24	16	22	21
Mediterranean-SAmerica ECoast	14	16	21	21
NAfrica-Europe	20	28	23	24
Southern Africa-Europe	14	15	17	14
Southern Africa-Far East	15	17	19	18
Southern Africa-Mediterranean	10	12	12	11
Southern Africa-NAmerica	5	6	7	7
WAfrica-Europe	45	46	38	35
WAfrica-Far East	13	13	14	12
WAfrica-Mediterranean	14	15	13	12
WAfrica-NAmerica	15	11	10	8

Source: *Containerisation International Yearbook*, various issues.

4. Implications for shippers and shippers' organizations

38. Shippers are direct beneficiaries of reductions in freight rates and improvements in the levels of services, both of which have been discussed above. Lower freight rates increase shippers' price competitiveness *vis-à-vis* competing suppliers. Similarly, improved services provide shippers with greater opportunities of service availability which meet their individual requirements and allow them to expand their trading opportunities.

39. In many countries shippers' councils and related organizations have been created to perform a variety of activities, including cargo allocation. In this regard, while in Latin America cargo reservation has largely been implemented through bilateral agreements and conference pool agreements, in some countries in Africa and Asia shippers' councils and/or freight booking centres have been the main instruments for allocating cargoes. A relaxation of cargo reservation or sharing would therefore have important implications for their role.

40. In Sri Lanka, liberalization involved a complete reformulation of the functions of the Central Freight Bureau, and a reactivation of a non-governmental shippers' council. The Bureau's exclusive rights to book/allocate cargoes has been abolished as indicated earlier in table 2, and the Bureau has been assigned new functions. In West/Central Africa the position is not clear, given that no concrete liberalization measures have been introduced. However, should the countries of the subregion decide to liberalize, the roles of the shippers' councils and their associated freight booking centres will have to be redefined. Currently the shippers' councils are mainly statutory bodies, which derive their revenues from service charges imposed on shipments. Liberalization may lead to a removal of these service charges and the privatization of the shippers' councils and hence the possible closure of freight bureaux. Should that happen, much groundwork will be required to promote the establishment of viable, private shippers' councils existing under the direct authority and management of shippers.[8] These changes may create other benefits for shippers. Councils created and controlled by shippers are more likely to provide services that meet the demands of the shippers themselves. They may also reduce the levels of charges now being imposed on them by the statutory shippers' councils.

5. Implications for employment opportunities

41. Protected public enterprises usually tend to be over-staffed since governments use them to satisfy political and social objectives, including the creation of employment opportunities. By exposing such enterprises to competition, they are forced to adopt cost-cutting measures including reductions in staffing levels. For developing countries with large fleets, the loss of employed persons, particularly of shore-based personnel may be an important policy and social issue that deserves the government's attention.

6. Implications for market structures

42. Market structures refer to a variety of factors that characterize a given market, e.g. the degree of competition among lines, the existence of barriers to entry, the relative strength of suppliers of services *vis-à-vis* users of services, etc. This subsection examines the implications of liberalization on the possible growth of concentration of liner services and development of market power among carriers. Such developments can take place at two levels, namely at the level of individual carriers and when several carriers cooperate with one another. While the growth of concentration and market power is the result of wider structural and market changes in the industry, liberalization, by expanding competition, should be considered as an important stimulant of the process.

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[8]In this context the UNCTAD secretariat has provided assistance to shippers' councils in redefining their functions and restructuring. The objective has been to enable the councils to defend users' interest effectively through negotiations with carriers and ancillary service providers, the provision of transport-related information and direct assistance to shippers relating to the transport of specific consignments. Implicit in this approach is a changeover in the nature of the councils from being political organizations to professional bodies. Such a process has been initiated in a number of African countries. Given the complexity of the issue, however, more time and work are needed to reach tangible results.

(a) Growth of concentration in individual lines

43. The concentration of liner services in a limited number of operators may result from lines exploiting economies of scale and scope. It has been suggested that both types of economies are important characteristics of liner shipping. Economies of scale are obtained when unit costs of operating a liner service decline as the scale of operation, including the line's volume of traffic, becomes bigger. Further, it has been observed that these economies are increased when the scale of operation includes multimodal links. Thus operators covering larger networks of trade routes that also include intermodal links would enjoy lower unit costs than those operating on a smaller scale and providing no intermodal links.

44. Economies of scope arise when a carrier offers a differentiated service, with more choice of service levels, more destinations and more frequent sailings. Shippers finds such a carrier more advantageous than obtaining the same services from separate carriers or uncoordinated separate carriers. The advantages arise from savings in information and search costs and other administrative costs which inevitably increase when a shipper has to deal with several carriers.

45. To derive economies of scale and scope, a carrier must usually have large investments in modern container ships and an extensive logistics system. Furthermore, to operate over a large network involves extensive use of shore-based facilities such as port terminals, wharves, trucking services, railways, etc. These facilities usually require large investments and are therefore supplied on the basis of contractual commitments, and in some cases mergers or vertically integrated operations and other strategic alliances, between carriers and the suppliers of the facilities. Large carriers are usually better placed to contract for such facilities on more favourable terms than smaller carriers, and also better placed to invest in them.

46. On the whole, therefore, there appear to be implicit financial barriers to entry into liner shipping, even if and when the industry is liberalized. While any operator can enter a liner service, the funds required to buy modern container ships and to finance operations, as well as the probability of limitations on access to shore-based facilities, imply that large operators are generally more likely to be more competitive than small ones. Some analysts have suggested that liberalized liner shipping services could go through the same market changes as deregulated air services have done, by tending towards high concentration. Also, while some observers have suggested that the existence of potential competition would be sufficient to prevent anti-competitive practices by large ocean carriers, others have emphasized factors that impede easy entry into liner shipping and thus make potential competition unimportant.

47. Available information suggests that, for example, on a global basis the ownership of the world's fleet of container ships is becoming increasingly concentrated in a few lines. For example it is reported in *Containerisation International*[9] that the share of the world's container slots controlled by the world's top 20 lines have increased from 38.8 per cent in 1990 to 41.9 per cent in 1992 and 43.7 per cent in 1993. In 1987 the share of the leading carriers was less than 35 per cent. The report predicts that the trend is likely to continue since the top carriers account for the largest share of new orders for container slots.

48. The above data concern carriers with the largest operations in the main east-west and around-the-world services. However, a number of those lines also operate in north-south, feeder and intraregional (as wayport operators) trades, where they tend to dominate services either directly or through affiliates. Thus, while the trend towards concentration may be more prominent in east-west and around-the-world services, it has spillover effects on other trades as the large operators rationalize their wayport and feeder services, and as north-south cargoes become integrated in the major east-west routes via transhipment.

(b) Growth of cooperation arrangements

49. In addition to expanding the size of operations of individual carriers, competition has also encouraged carriers to cooperate in order to rationalize

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[9] *Containerisation International*, November 1993, pp. 32-39.

services jointly as a means of facing rising costs and declining rates. Many liner operations now involve cooperation ventures such as space chartering, joint service agreements, vessel sharing, equipment interchange, etc. These forms of cooperation enable carriers to cut costs, to share risks and improve services, all of which may not be possible if carriers operate individually.

50. While the growth of individual lines and cooperation among lines may be necessary conditions for exploiting economies of scale and scope and improving efficiency, both may have adverse effects on market structures. The ability of a few individual lines or groups of lines to control large segments of liner services may grant them market power, enabling them to distort prices and engage in anti-competitive practices.

7. The need for competition rules and implications for the United Nations Liner Code

51. The previous subsection has described the growth of concentration and cooperation ventures in liner trades, both of which may be enhanced by liberalization. The cooperation arrangements have developed alongside traditional conference lines. The latter have usually been subject to national laws aimed at preventing them from engaging in anti-competitive practices. At the international level the United Nations Liner Code was established also to provide rules aimed at minimizing the adverse effects of the conference system.

52. On the other hand, while some countries have established rules to prevent anti-competitive practices by the other forms of carrier agreements, e.g. consortia and trade-wide stabilization agreements, the position of the United Nations Liner Code regarding such agreements remains to be clarified. At the first Review Conference on the Liner Code in 1991, the implications for the Code of the new structures in liner shipping were recognized, although there was no consensus reached on policy actions to be adopted. The present situation means that the Code may perhaps not be applied to carrier agreements which in many ways may have the same anti-competitive effects as traditional conferences. Yet the active engagement by certain jurisdictions, e.g. the United States and the European Union, to design or update laws dealing with consortia and stabilization agreements is clear evidence of the need for action at the international level as well. Thus, the encouragement to developing countries to liberalize has to be accompanied by the establishment of suitable competition laws to ensure that the competition and other gains that result from liberalization are not eroded by carrier agreements that lead to the exercise of market power. In this connection, efforts to make the Code up to date would be essential. This would not only minimize jurisdictional conflicts, which are bound to arise if individual countries or groups of countries continue to develop separate competition laws. It would also be a more practical alternative to possible attempts to conclude a new set of competition rules in maritime transport.

Chapter IV

OTHER DIMENSIONS OF LIBERALIZATION

53. Previous chapters have focused on the possible results of liberalization. However, it is also important to examine the approaches to be used in formulating and implementing specific liberalization programmes. This chapter outlines some aspects which decision makers would need to take into account. It is beyond the scope of the present report to examine in detail the actual mechanics of liberalization, and therefore issues are raised briefly mainly as a listing of topics which may be taken up in the future work of the Committee. The aim is not to provide an exhaustive treatment of any topic, but mainly to indicate the type of issue which may need to be dealt with by the Committee in its efforts to promote liberalization.

A. The extent and speed of liberalization

54. In formulating a liberalization programme, specific questions arise, including: by how much should cargo reservation be reduced; should all subsidies be removed or should some be retained; should government-owned shipping enterprises be fully privatized or should the government retain some participation, and if so how much; what share of ownership should foreign capital be allowed in national shipping companies, should privatization focus on management or include ownership as well, etc. In addition, decisions on more detailed aspects have to be made. For example, if shipping enterprises are to be privatized, to whom should the enterprises be sold; what should be the mode or combination of modes of sale - e.g. auction, tenders, private sale of shares, public offering of shares, employee buy-outs, through stock markets, joint ventures, etc. Should sales be made to a few buyers or a wide range of buyers. In some cases the decision may be even more complicated, e.g. some countries wishing to privatize companies have found that prevailing freight market conditions do not induce private capital to invest in those companies, in spite of government efforts to rationalize and restructure the companies concerned to make them more attractive to buyers. Governments may therefore be left with a choice between liquidating companies, or selling them at give-away prices or continuing to support them in the expectation of improved markets.

55. While the present report refers to progressive liberalization, a given programme has to determine specific targets and time-frames within which to undertake different measures. It is important for the speed of liberalization to be properly balanced. If undertaken too fast, a liberalization programme can be disruptive and self-defeating, leading to the possible dislocation of the enterprises concerned. Thus, for example, an abrupt elimination of subsidies to shipping could lead to the collapse of shipping enterprises which, in the long run, could have become viable and self-supporting if the subsidies had been withdrawn gradually. On the other hand a programme that drags on for too long may be perceived as not being serious and may lose the confidence of the private sector or external donors. It can also be argued that fast liberalization may prevent the creation of interest groups adversely affected by the liberalization and therefore opposed to it.

B. Legal basis for liberalization

56. Implementation of liberalization may require modification of some laws or the establishment of new laws. For example existing protectionist measures may have been established through legislation or executive orders or decrees, etc. These have to be repealed or amended in order to provide liberalization with a legal basis. Again, in a country where the tradition of free enterprise is limited, a legal system would need to be set up to protect private ownership and property rights. Also, as mentioned earlier, competition rules would be required to complement the liberalization process.

C. Unilateral versus bilateral or multilateral liberalization

57. Some of the examples of shipping policy reforms given in table 2 are unilateral initiatives by the individual countries concerned. The success of unilateral liberalization may be limited if the level of competition is restricted by the fact that non-liberalizing countries continue to protect their shipping enterprises. In the long run, the enterprises of the liberalizing country may be unable to maintain competition and the initiative may fail. However, if successful, unilateral liberalization may provide lessons for other countries and encourage them to follow suit.

58. Liberalization may, alternatively, be promoted through bilateral agreements. However, under such agreements, while markets for shipping services are opened to the enterprises of the parties to the agreement, the result is market sharing, and external competition from third parties is usually excluded. A third option is to liberalize in the context of regional trade agreements or customs/economic unions. The Andean Group initiative cited in table 2 is an example of this approach. Finally, liberalization may be undertaken within the framework of a multilateral agreement. In this regard, while the United Nations Liner Code is more concerned with establishing competition rules, it does contain some provisions aimed at liberalizing shipping services, although other provisions are protectionist. On the other hand, the General Agreement on Trade in Services (GATS), concluded in the Uruguay Round of Multilateral Trade Negotiations, sets out a broadly based framework for liberalizing trade in services, including maritime transport. However, negotiations on maritime transport services were not finalized.[10]

59. In principle, the various frameworks for formulating and implementing liberalization are feasible, and may co-exist with each other. However, countries need to assess the pros and cons of each approach.

D. The sequencing of liberalization measures

60. A liberalization programme may comprise a number of measures as outlined earlier. It may be essential to introduce the individual measures in some sequence, partly to ensure that the country's administrative machinery is not strained due to the simultaneous introduction of a large number of changes. Sequencing may also help to minimize possible conflicts between the outcomes of different measures. For example, it has been suggested that the privatization of State-owned monopolies should ideally be preceded by exposing them to competition. If they are privatized before competition is introduced the outcome may merely be to transform public monopolies into private ones, since buyers of the enterprises concerned, in order to avoid making losses, might oppose measures to promote competition. For example, potential buyers might be attracted to a company which has reserved cargo rights, but if competition is introduced by removing those rights the company may not find buyers. Thus, initially, the establishment of competing shipping services could be promoted before protected public shipping lines are privatized. Alternatively public shipping lines could first be restructured prior to their privatization. For example, they could be removed from direct State control and reorganized into corporations with independent boards of directors, and run on a commercial basis. Once they have gained the experience of operating commercially, they could then be privatized.

E. Transitional arrangements

61. Liberalization exposes to competition enterprises that were previously protected. Such firms would normally have incurred "sunk" costs, which may place the firms at a disadvantage in a liberalized environment. For example, shipping companies may have made investments and other financial commitments based on protected markets. Liberalization may cause financial losses as a direct result, for example, of being deprived of assured access to cargoes. It can be argued that in such cases the companies concerned should be permitted to recover the financial commitments made under conditions of protection. Similarly, shippers

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[10]At the conclusion of the Uruguay Round in December 1993, it was decided to set up a Negotiating Group on Maritime Transport Services (NGMTS), with a mandate to enter into further negotiations, on a voluntary basis, in the sector of maritime transport services, within the framework of GATS. The NGMTS is to conclude negotiations and make a final report no later than June 1996.

may have made long-term contractual arrangements with carriers during the period of protectionism. These commitments can also be regarded as "sunk" costs at least in the short run. With liberalization, alternative services may become available, offering the shippers a greater choice of services and more competitive freight rates, but, because of the long-term contracts,[11] they may be constrained in seeking alternative services.

62. It has been suggested that carriers or other institutions that incur "sunk" costs in a pre-liberalization period should be given temporary protection or compensation during the transition to liberalization to allow them to adjust to new conditions and to give them "comparability" with competitors that have not incurred such costs. This approach, however, may be opposed on the grounds that it may encourage the search for new schemes to restrict competition, and also that it may encourage transport users to continue relying on protected service suppliers instead of seeking out alternative services provided by competitors. In short, it may constrain the overall development of competition during the transition period.

F. The role of governments in promoting liberalization

63. While liberalization involves a relaxation of government intervention and controls, on the other hand the government has to play a leading role in taking supportive measures to ensure its success. Mention has already been made of the establishment of a legal framework and competition rules. Governments would need to institute other measures, including the provision of incentives to attract foreign investment, the establishment of a taxation system that safeguards the competitiveness of national shipping lines, the provision of adequate infrastructure, e.g. port facilities, the training of on-board and shore-based personnel, etc. The State may also establish or strengthen maritime administration to ensure that operators meet safety and environmental regulations and other maritime laws. In certain cases governments have established special bodies to oversee the implementation of liberalization programmes in different sectors.

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[11]Long-term contracts would apply more to bulk trades and less to liner services.

Chapter V

DIFFICULTIES FACED BY SERVICE SUPPLIERS OF DEVELOPING COUNTRIES IN PROVIDING COMPETITIVE SHIPPING SERVICES

64. A crude indicator of the level of participation by developing countries is shown in table 6 which gives the percentage shares of the world merchant fleet owned by developing countries, excluding the major open registries. If the tonnage registered in newly-established registries[12] is deducted, the shares become even smaller. As mentioned earlier, flag registration may not fully reflect the level of participation because operators also employ chartered tonnage. However, the figures in table 6 are a useful indicator.

Table 6

World merchant fleet shares owned by developing countries by type of vessel in selected years a/

Year	Percentage share owned				
	Total fleet	Tankers	Bulk carriers	General cargo vessels	Container vessels
1970	6.3	4.5	5.1	12.6	0.1
1975	6.1	3.7	4.4	13.6	1.2
1980	10.0	7.7	9.2	17.6	7.6
1985	17.1	12.9	19.4	24.0	12.1
1990	21.1	16.3	25.6	26.2	16.0
1991	21.1	16.0	25.2	26.9	17.9
1992	21.6	17.1	25.7	26.6	18.1

Source: UNCTAD, *Review of Maritime Transport*, various issues.

a/ Developing countries excluding major open-registry countries (Bahamas, Bermuda, Cyprus, Liberia and Panama).

65. The level of participation and competitiveness of service suppliers of developing countries are low as a result of a number of difficulties. In previous chapters, mention has already been made of the problem of lack of ship finance, and also in the liner sector the tendency towards greater concentration, which tends to work against small operators, including most developing country service suppliers. A number of other factors that create difficulties are outlined below.

A. Continued protectionism

66. Even though a number of developing countries have embarked on liberalization, protectionism persists in both developing and developed countries. Many governments continue to provide subsidies and other financial assistance to shipping, and to give cargo preference to national operators, etc. in both liner and bulk shipping. The precise magnitudes of these forms of protection are not known, although their presence implies that shipping lines of developing countries which do not provide them face unfair competition from lines which continue to be protected.

B. Use of open registries

67. The use of open registries offers shipowners access to labour that is cheaper than in home countries. For example, Drewry reports that in the 1980s,

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[12]These include, among others, Antigua and Barbuda, Cayman Islands, Honduras, Hong Kong, Malta, Mauritius, Singapore, Sri Lanka, St. Vincent and the Grenadines and Vanuatu. While the Philippines is not an open registry in the conventional sense, it has operated a bareboat charter scheme, which has had a direct impact on the country's substantial fleet expansion. Under the scheme, foreign shipowners are registered in the Philippines through companies based there.

by flagging out to open registries, United Kingdom operators were able to make savings of over 40 per cent in manning costs through the elimination of owners' pension fund costs, social security costs and other fringe benefits, and also the elimination of extended tour lengths and lower leave entitlements, resulting, overall, in fewer seafarers being required.[13] This phenomenon, and the increasing importance of capital intensity in liner shipping, have further reduced the competitiveness of developing countries. Thus the use of open registries obstructs competition by placing developing country shipowners that employ regular registries at a cost disadvantage. The importance of this is demonstrated by the rapid growth of open and international registries in recent years. Figure 4 gives a comparison of the annual growth rates between the fleets of developing countries that have eased conditions for ship registration, and developing countries that do not have such registries. The fleets of the former group of countries show a sharp increase in registered tonnage from 1989, and although in 1992 the rate of growth decreased, it was still around 15 per cent. This compares with the non-open registry developing countries whose tonnage has remained rather stagnant. The importance of the open registries is further evident from the increasing tendency of developing countries to register their ships under them.

C. Structural changes in liner shipping

68. The majority of developing country liner operators were established and expanded under the umbrella of liner conferences. The conferences assured them of stable rates and the opportunity to cooperate with other lines in scheduling sails, sharing tonnage as well as certain administrative costs. Conference membership thus did offer some "protection" to lines that helped them to enhance their ability to provide services. The relative decline in conferences and the volume of trade covered by them has meant some loss of the "protection" that lines enjoyed through conference membership, and hence of their ability to compete. Conference membership has in many cases been replaced or complemented by other forms of carrier cooperation. While developing country carriers may participate in the other cooperative arrangements, it is not certain that these arrangements will offer them the same "protection" they used to enjoy in conferences.

D. Business affiliations and access to capital

69. Shipping companies of many developing countries tend to be pure transport ventures. Given the cyclical nature of shipping markets and the consequent low profitability, this means that such ventures are constantly exposed to financial constraints. On the other hand, many shipping enterprises of developed countries tend to be affiliates or subsidiaries of large, diversified enterprises. The parent companies are thus able to cushion the financial constraints of the transport activities by earnings from other lines of business. This enables them to expand and improve shipping services to a much higher degree than the developing country companies which rely entirely on earnings from shipping operations.

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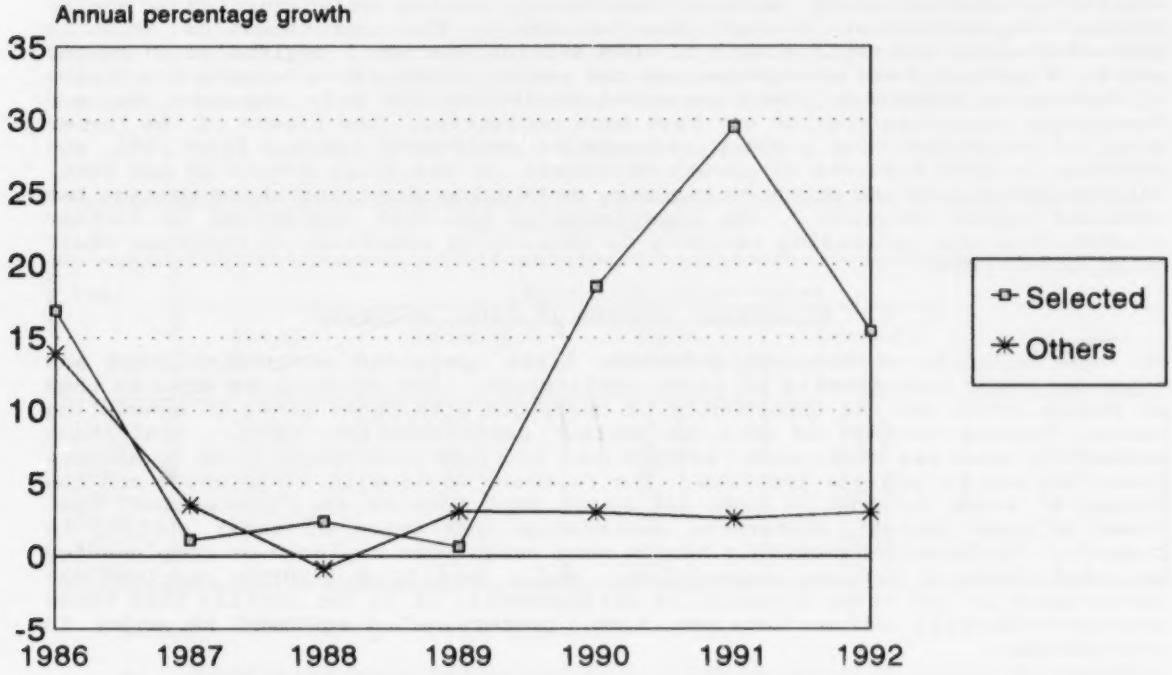
[13] Drewry, *Ship costs - Their structures and significance*, August 1990, page 57.

Figure 4

Comparison between growth rates of fleets of selected developing countries a/ that have eased conditions for ship registration and other developing countries, 1986-1992



Source: Based on UNCTAD, *Review of Maritime Transport*, various issues.

a/ The selected developing countries that have eased ship registration conditions include Antigua, Cayman Islands, Honduras, Hong Kong, Lebanon, Malta, Mauritius, Singapore, Sri Lanka, St. Vincent and the Grenadines, Tuvalu and Vanuatu. Other developing countries exclude those listed above and also Bahamas, Bermuda, Cyprus, Liberia and Panama.

E. Technological gap

70. In the liner industry operational efficiency and competitiveness are significantly influenced by the operators' level of technological progress which is dependent on the employment of modern container ships, the ability to provide door-to-door services over large networks, the provision of EDI systems to communicate with customers and the exploitation of logistics and improved marketing techniques. In turn these factors are dependent on a line's capital endowments and expertise in logistics, marketing, etc. In the majority of cases, shipping lines of developing countries have less access to these technological advances than those of developed countries. Many fleets of developing countries still have a large component of break-bulk or multi-purpose vessels which they employ in mixed break-bulk/containerized operations, which are relatively inefficient and uncompetitive. Despite opportunities for cooperation between lines, this technological gap is not likely to be eliminated through joint ventures, consortia agreements, etc. In particular, as developing countries liberalize their shipping services, thus increasing market access, the incentive

F. Tonnage overcapacity

71. Liner shipping suffers from chronic tonnage overcapacity which is caused by a number of factors. While the overcapacity affects all operators, it is often exploited by large carriers that are in a position to maintain surplus tonnage as an instrument of competition. By employing surplus tonnage, they can increase service frequency and expand market shares at the expense of competitors. The shipping lines of many developing countries have small fleets and are therefore not in a position to maintain strategic surplus tonnage. Instead, being the weakest competitors, they are often the victims of the overcapacity problem.

G. Marketing and shipment arrangements in bulk shipping

72. The participation of developing countries in the transportation of bulk cargoes has been more limited than in liner trades. While it has been suggested that there exist barriers to entry into dry and liquid bulk transportation that have hindered the competitiveness of and participation by developing countries, there has not been a consensus on this matter. In this connection, UNCTAD has previously carried out two investigations to determine the problems faced by the developing countries in competing in the international seaborne transportation of dry and liquid hydrocarbon cargoes.[14] Both investigations, carried out by groups of experts, were inconclusive, although they made a wide range of recommendations aimed at creating conditions to enhance the ability of developing country operators to participate in the transportation of seaborne bulk cargoes.

73. Many of the factors outlined above have been studied previously in the UNCTAD secretariat in the past.[15] In the intervening period, however, there have been major changes in the technologies and methods used by transportation systems. These developments must have influenced changes in the factors that create difficulties facing service suppliers of developing countries. While this chapter has given a general outline of existing problems, based on published sources available to the secretariat, more focused investigations, by the Committee, of individual subjects appear to be necessary to arrive at more substantive conclusions and recommendations.

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[14]See UNCTAD, "Report of the Group of Experts on problems faced by developing countries in the carriage of bulk cargoes on its second session", held at the Palais des Nations, Geneva, from 30 November to 4 December 1981 (TD/B/C.4/234-TD/B/C.4/AC.2/5), and UNCTAD, "Report of the Group of Experts on international sea transport of liquid hydrocarbons in bulk on its second session", held at the Palais des Nations, Geneva, from 30 January to 3 February 1984 (TD/B/C.4/263-TD/B/C.4/AC.3/5).

[15]In addition to the investigations of the ocean transportation of bulk cargoes, detailed studies have been carried out on ship finance, the imbalance between supply and demand in world shipping, and open registries.